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December 7, 2000

Magalie Roman Salas
Secretary
Federal Communications Commission
Room TW-A325
445 Twelfth Street, N.W.
Washington, D.C. 20554

EX PARTE OR LATE FILED

RECEIVED

DEC 7 2000

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Re: CC Docket Nos. 96-98; 99-68

Dear Ms. Salas:

On December 6, 2000 Wally Griffin, President and Chief Executive Officer and John Sumpter, Vice President of Regulatory of Pac-West Telecomm, Inc., Andrew D. Lipman and I had meetings with the Chairman, Kathy Brown and Anna Gomez; Commissioner Furchtgott-Roth and Rebecca Beynon; and Jordan Goldstein. During these meetings, issues relating to intercarrier compensation, including why bill-and-keep was not an appropriate public policy goal, were discussed. The attached materials were used during the meeting. In addition, attached is a study titled, "California's Internet Service Providers View Reciprocal Compensation, Affordable Internet Access & Rural Internet Access: An Analysis of Survey Results" by Yale M. Braunstein and Rashmi Sinha of the University of California, Berkeley. This study demonstrates the negative impact of imposing bill-and-keep on Internet Service Providers and on the accessibility and affordability of Internet access in California, particularly in rural areas. The authors conclude that the ISPs foresee a decline in ISP competition, an increase in the cost of internet access with some communities facing the complete loss of local access to the Internet.

In accordance with Section 1.1206(b)(2) of the FCC's Rules, an original and two copies of this letter are being filed with your office for inclusion in the public record.

Sincerely,



Richard M. Rindler

cc: Chairman Kennard
Commissioner Furchtgott-Roth
Kathy Brown
Anna Gomez
Jordan Goldstein

A. Goodfellow
Vice President
Regulatory

140 New Montgomery Street, Room 1814
San Francisco, California 94105
(415) 542-4810

Ex. 121
PACIFIC * BELL.
A Pacific Telesis Company

April 3, 1995

President Daniel Wm. Fessler
California Public Utilities Commission
505 Van Ness Avenue, Room 5218
San Francisco, Ca. 94102

Dear President Fessler,

The settlement process may be over but our commitment to local competition remains very strong. Attached are two items; a summary of the Plan titled "Competition to the Core", and a more detailed description of how the plan can be implemented to move ahead with local competition even earlier than the Commission's January 1, 1997 target. We believe that the Plan provides what Californians want. Californians enjoy service quality and network reliability which is among the best in the U.S. and the world. They don't want this to be placed at risk by plans that would prevent current Local Exchange Providers from continued investments.

The Plan rests on two simple points. First, it focuses on the Commission's objective of opening local markets soon. Second, it addresses the integrated issues that require action when local markets face wide-open competition instead of relying on stop-gap interim rules. We urge that the Commission promptly move ahead with proceedings on NRF reform, rules for Local Competition, and adoption of a specific plan to protect Universal Service. We also note that pending federal legislation is designed so that presubscription and InterLATA relief occur at the same time. Given this development, the Commission should turn its attention - and apply its limited resources - to proceedings that will bring about Local Competition, NRF Reform, and Universal Service Protection on a coordinated basis. The Plan does just that.

Thank you for considering these proposals, and we look forward to working with the Commission and other parties to bring life to the Commission's Infrastructure Report Goals.

Sincerely,



Attachments
cc: J. Jimenez

"Competition to the Core" **California's Plan for Local Telecommunications Competition**

California's goal is to "open all markets" to competition by January 1, 1997. Local Competition is a top priority which Pacific Bell endorses. But throwing local markets open without reforming regulation and also without enabling competition across the board would be a damaging and lasting mistake. It would be wrong to assume that local competition will have no effect on universal service. Californians enjoy service quality and network reliability which are among the best in the U.S. and the world. They don't want this to be placed at risk by plans that would prevent current Local Exchange Providers from continued investments. Before local competitors unleash their highly targeted marketing plans to capture the most profitable revenues -- revenues that are the bedrock of universal services -- a plan to protect universal service must be in place.

"Competition to the Core" is a plan to open all California telecommunications markets and services to competition as early as January 1996. The plan provides customers with the benefits of competition and provides the competitors with all of the flexibilities needed to effectively enter any market that they choose. The plan has the following components and objectives:

Universal Service and Consumer Protections:

California customers have the highest quality service at some of the most affordable prices in the nation. That can't change. The plan continues high quality service, the most successful Lifeline program in the nation, and puts in place a universal service funding mechanism to make sure no Californian sees a loss in quality of service.

Rates and Open Entry for all Services:

Competitors should be able to enter any market with minimal regulation by January 1, 1996. An expedited procedure for entry should quickly be adopted.

Competitive Response to Most Actual Competitors:

Where competitors enter, incumbent LECs are permitted to lower price and offer new services with the same regulation that governs new entry so long as other prices for basic services are not raised.

Unbundled Networks at Some of the Lowest Prices in the Nation:

Pacific Bell will unbundle its network into links (loops), ports (switching), and access to signaling systems. Moreover, a \$10 link price will be provided, a price which is below Pacific's basic prices and a price which is among the lowest, if not the lowest, state-wide link price in the nation. A range of port types are provided starting with a basic port at \$4.50/month.

Interconnection of Networks at Some of the Lowest Prices in the Nation:

Pacific Bell will interconnect with local competitors for a price of about 1.4 cent a minute (for terminating traffic), which again is one of the lowest interconnection prices in the country.

"Competition to the Core"
California's Plan for Local Telecommunications Competition

Interim and Permanent Number Portability, Including a Number Portability Trial

Pacific Bell will provide immediate number portability through a remote call forwarding-like service. The price -- \$3 a month with no usage charge -- matches the low price recently agreed to in New York. Moreover, Pacific Bell will commit \$5,000,000 toward a standards based number portability trial if other industry participants will match that amount.

Resale of Local Exchange Services

As soon as interLATA relief is implemented, full resale of basic exchange services will be offered, including both the access line and local usage.

Reform Regulation WITHOUT RATE REBALANCING or RAISING ANY BASIC PRICES:

Today's regulation needs to be changed to eliminate sharing, price indexing, and earnings caps and floors. This should happen effective for 1996, and Pacific Bell will cap current basic prices for three years.

HOW WILL THE PLAN BE ACCOMPLISHED?

Proceedings should be started immediately to adopt the rules for local competition, reform current regulation, and establish a plan for universal service funding. The Commission has already said that it will start a local competition proceeding and a proceeding for regulatory reform. It has in place a rule making proceeding for universal service. These proceedings should move ahead immediately, with two objectives:

- The Commission should continue to urge parties to settle these issues;
- Local competition, with regulatory reform and a universal service funding plan, should take effect in early 1996.

Are interim local competition rules necessary?

No. Interim rules will not address the broader issues of regulatory reform, competitive response, and universal service funding that are required before local competition can be effective. The Plan proposes that the Commission deals with all outstanding issues so that it can introduce rules that provide maximum benefits for customers and a fair balance among competitors. If interim rules are still desired, the plan proposed in Pacific Bell's January 31, 1995 filing should be adopted.

Does the Commission have to act on preemption?

Again, the answer is plainly no. Pending federal legislation has tied preemption to RBOC entry into the interLATA market. It would be premature, and possibly meaningless, for the Commission to commence a long and contentious proceeding on these topics when federal legislation could resolve the matter. As Judge Harold Greene stated seven years ago, preemption without interLATA authority would put BOCs at an "insuperable disadvantage." The competitive imbalance would create long term service risks for California. Pacific Bell agrees -- as it always has -- to move ahead immediately with preemption when interLATA relief is implemented.

"Competition to the Core"
California's Plan for Local Telecommunications Competition

**THE FOLLOWING IS A MORE DETAILED DESCRIPTION OF THE PLAN
"COMPETITION TO THE CORE"**

I. Universal Service

The cornerstone of any effective plan for opening local markets to competition is a good Universal Service Plan. Most policy makers agree that there is a need to maintain telecommunications universal service. For the benefit of society, public policy requires that certain services should continue to be priced below cost. The services which are generally priced below cost are basic access lines and local usage. To the extent that these costs are not covered by the prices for these services, the costs are subsidized by prices of toll and switched access charges which are significantly above cost. A subsidy pool exists today which is funded by Pacific Bell's toll and switched access services. The pool then pays the uncovered costs of services which are priced below cost. The fundamental precept of the plan is that all suppliers of these services — not just Pacific Bell — should fund universal service in a competitively neutral way.

The plan shows how the current internal Pacific Bell subsidy pool can be made more generally applicable to the needs of the total local exchange industry as the market is opened to competition. The Universal Service Solution shall address state and interstate universal service funding requirements and shall meet the following requirements:

1. The Fund shall apply to below cost Basic Services provided by a carrier of last resort (COLR).
2. Basic Services are the following:
 - a. Voice Grade Residence Local Exchange Service (includes access to directory assistance, operator service, emergency service)
 - b. Voice Grade Business Local Exchange Service (includes access to directory assistance, operator service, emergency service)
3. All providers of local telecommunications services, whether facilities based or resale, should contribute to the Universal Service Fund in a competitively neutral manner.
4. All universal service support should flow from the Universal Service Fund. All implicit or hidden subsidies should be eliminated upon implementation of the Fund.
5. In addition to meeting the above described prices vs. cost deficit, Universal Service should be supportive of the achievement of the goal of 95% penetration of disadvantaged customers, meeting the needs of deaf and disabled customers, and the provisioning of lifeline service.

II. Entry by New Providers:

New entrants have requested immediate approval to enter local markets and the CPUC has stated their goal to open the local markets to competition by January 1997. Pacific Bell's plan provides for significant new competitive opportunities in 1995 and very broad market opening as early as January 1996 which includes unbundling of local facilities.

"Competition to the Core"

California's Plan for Local Telecommunications Competition

New Entrant Certification:

New entrants have asked for streamlined processes for entry and certification with minimum regulation. The Plan would enable new entrants to enter effectively. Requirements proposed for certification are consistent with and no more stringent than processes already designed by the CPUC to protect the customers of California. The Plan provides the consumer protection requirements that are in place today for existing LECs. Requirements such as those which protect Customer Proprietary Network Information are important to customers and Pacific's plan supports the CPUC's emphasis on such consumer protections. Pacific continues to be obligated to meet service availability and quality standards.

III. Competitive Response by Incumbent LECs:

Consumers will receive maximum benefits from a communications market in which all participants can compete vigorously. All competitors must have equal rules and requirements governing competitive flexibilities.

Downward Pricing Flexibility:

The Plan enables new entrant LECs to enter all or any part of the California market that they choose. The relaxation of regulatory requirements on Pacific Bell should be effective only for the areas in which competitors have requested certification. In such areas where competitors have entered, Pacific should be given downward pricing flexibility. In addition, Pacific Bell commits to not increase basic service prices in any area for 3 years with the implementation of this complete plan. Reduced prices are obviously of benefit to customers.

IV. Resale of Basic Services:

In their public filings, new entrants have asked that Pacific Bell offer all of its basic services for resale. The Plan makes this offer to be implemented at the time that Pacific is permitted to enter the interLATA markets. This is one of the most significant offers in the plan because it enables the very large number of competitors who have little or no facilities to enter the market. It is also of significant value to current IECs with facilities.

V. Access to Telephone Numbers:

Number Assignment

Pacific Bell will continue to act as the NNX custodian until a third party custodian is established. In the role of custodian, Pacific will provide access to telephone numbers (and NNX's until a permanent number portability solution is implemented) for assignment to new entrant LEC's telephone exchange service customers based on the CPUC defined rate areas. New entrants have asked for complete flexibility in the assignment of numbers to customers. The Commission understands the importance to customers of number planning, and particularly the importance of the relationship of particular NNXs to geographic locations. Wide-open access to numbers could cause chaos for customers. For example, if numbering issues are not carefully considered and implemented, customers will not know if a call is a local or toll call.

The Plan requires that existing rate areas, as established by the CPUC, be maintained. This enables continued geographic recognition by customers to permit estimation of call costs. Using the existing rate areas does not restrict the flexibility of new entrants to offer any creative pricing and service bundling plan that they may wish to establish. New entrants need not offer local calling included in a low line rate even though Pacific may continue to be obligated to do so.

"Competition to the Core" California's Plan for Local Telecommunications Competition

Number Portability

In their public filings, new entrants have stated that number portability is necessary for open competition. The Plan offers competitors the best form of number portability available today plus a commitment to support the development of new technology for number portability. Until long term number portability is developed, number portability will be provided through remote call forwarding with a very attractive price. The price offered is \$3.00/month per line with no usage charges associated with the number portability feature. A long term number portability arrangement will be implemented when national standards are created and implementation is technically feasible and economically reasonable. Pacific Bell agrees to conduct a permanent number portability trial designed consistent with national standards. Pacific Bell will invest \$5 million for the development of permanent number portability if other industry participants will contribute a like amount.

VI. Unbundling of LEC Networks:

New entrants have asked to be able to utilize Pacific's local loops and switching systems on an unbundled basis in conjunction with their own facilities. The Plan offers local loop transmission (i.e., transmission from the central office to the customer's premises) unbundled from local switching or other services and local switching unbundled from the remainder of the network. The Plan would make these available by January 1996. The Plan price of an unbundled loop is \$10.00 per month plus universal service funding and end user common line charge.

Access to Pacific Bell Facilities:

New entrants have also asked for access to the poles, ducts, conduits, and rights of way owned or controlled by Pacific Bell where Pacific has the legal authority to permit such access and where there is capacity available. The Plan provides for this access.

Access to Pacific Bell Support Services:

New entrants have asked for access to support services. The Plan provides for access to 911 and E911 services and also access to directory assistance services to allow other carrier customers to obtain telephone numbers. The plan also offers access to operator call completion services and also white and yellow pages directory listings. Also offered is effective coordination of end user repair, maintenance, and activation services.

VII. Network Interconnection:

New entrants have asked that interconnection arrangements be established for completion of local calls between LBOs with appropriate coverage of the costs of the use of each network. The Plan establishes the capability to exchange local calling between customers of two or more local carriers with reciprocal compensation arrangements between the carriers. The prices for interconnection will be equal to switched access charges, about 1.4 cents per minute, which is among the lowest in the country. New entrants should establish their interconnection prices based on their costs.

Most Point:

The Plan permits each carrier specify where their facilities will terminate on (most) the facilities of the other carrier and this is what new entrants have requested.

VIII. Presubscription (IntraLATA Equal Access):

New entrants have asked that equal access (1+ dialing, no 10XXXX) be implemented for intraLATA calls. Presubscription will be implemented when interLATA relief is granted so that extra digits are not required to reach the presubscribed carriers for any calls.

IX. Centrex FRS:

Material deleted in compliance with ex parte rules.

X. Resale of Basic Services:

New entrants have asked to be permitted to resell basic services. When interLATA flexibility is authorized, Pacific Bell will offer to resell its local access lines (with or without local usage) and intraLATA services. Access lines and local usage will be offered to others on a resale basis on the same basis that these services are charged internally for Pacific Bell's own marketing of the services.

XI. Regulatory Reform - Changes to Regulation

The Plan calls for the transformation of the current new regulatory framework (NRF) structure to a pure price regulation structure when local competition is authorized. This Plan recognizes that the market structure for which NRF was designed has changed. The Plan's specific proposals are:

- Elimination of price indexing (inflation less productivity).

- Basic prices are frozen for three years, with only downward pricing flexibility allowed, as a part of the adoption of the overall plan.

- Earnings floors, ceilings, and sharing are eliminated.

- Except for jurisdictional cost shifts, Z factors are eliminated.

XII. Satisfying Costa Bill Requirements:

The Plan provides all of the ingredients requested by the California Legislature in the Costa Bill. Upon implementation of the plan, Pacific Bell will meet the Costa Safeguards.

XIII. InterLATA Market Entry:

The Plan calls for permission to enter the interLATA market at the time that resale and presubscription are implemented. If local markets are opened to unrestricted competition while the local exchange carriers are barred from providing long distance service - even within California - California customers will be disadvantaged. Customers would be denied one-stop shopping at Pacific Bell - the only major California based competitor. Thus, competition would be reduced and customers would pay more for less value.

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the
Commission's Own Motion into
Competition for Local Exchange Service)

R.95-04-043

Order Instituting Investigation on the
Commission's Own Motion into
Competition for Local Exchange Service)

I.95-04-044

NOTICE OF EX PARTE COMMUNICATION

Pursuant to Rule 1.4(a) of the Commission's Rules of Practice and Procedure, Pacific Bell (U 1001 C) hereby gives notice of the following ex parte communication.

On June 30, 1995, John Guekdner, Vice President - Regulatory Relations, Pacific Bell met with Commissioner Conlon, Richard Smith, Advisor to Commissioner Conlon and Jack Leutza, Chief, Telecommunications Branch of the Commission Advisory and Compliance Division. Martin Ard, Assistant General Counsel for Pacific Bell was also present. The meeting occurred at Commissioner Conlon's office at 505 Van Ness Avenue, San Francisco from 12:30 p.m. until about 1:30 p.m.

At the meeting, Pacific Bell (Pacific) provided a two page document and the conversation centered on the document. A copy is attached to this notice.

Pacific began the discussion by going over the first four points. Pacific stressed that there should only be facilities-based interim competition, no resale, no

unbundling and that competing local exchange carriers should be directed to form interconnection agreements. Any interconnection disputes may be resolved in hearings. All other issues, including resale, the degree of unbundling, unbundling elements, costs and prices would be incorporated in the OANAD schedule already established by the Assigned Commissioner's Ruling. Hearings should be held in 1996 for local competition to begin January 1, 1997.

Pacific also requested that the Interim Rules be approved with the modifications that are noted on the second page of our document.

Pacific explained that resale is not possible without hearings. The Commission would be much better served by initiating facilities-based competition and holding hearings in 1996 to set resale terms and conditions, rather than rushing ahead with a hastily considered interim resale proposal. Resale prices set at current tariffed prices, or even at cost as established in IRD, would be inadequate. It would also undermine Universal Service because it would allow interexchange carriers (IECs) to capture, through 10XXX dialing, Pacific's most profitable customers. IECs could take 10-15 percent of Pacific's most profitable customers leaving Pacific to serve millions of customers paying below-cost basic prices with little or no toll. Universal Service funding would be crushed. Pacific pointed out that nothing in pending legislation requires resale before 1997 and stressed that resale should occur when Pacific obtains interLATA authority.

Pacific also urged that pricing flexibility be granted for its Category I exchange services in those areas subject to local competition. The Commission should not allow IECs to bundle interLATA services with local exchange services. By imposing

this fairness limitation, Pacific and its competitors would both be free to package intraLATA toll and exchange services. Once Pacific is permitted to offer interLATA services, the restriction could be lifted.

Pacific closed the meeting by stressing that the Commission's Infrastructure Report goal to open all markets at the same time in 1997 is the right course. The Commission can achieve this goal by adopting facilities-based interim competition, without resale or unbundling. The Commission would then be able to hold hearings in 1996 and adopt a workable Universal Service Funding mechanism.

To obtain a copy of this notice, please contact:

Lila Tam
140 New Montgomery St., Rm. 2522
San Francisco, CA 94105
Telephone: (415) 542-9288
FAX: (415) 543-3766

Respectfully submitted,


R. E. Sawyer
Director - Case Management
Pacific Bell

July 6, 1995

WHAT SHOULD THE COMMISSION ORDER?

- FACILITY BASED INTERIM LOCAL COMPETITION
- ENTRY AND INTERCONNECTION
- UNBUNDLE LINKS AND PORTS BY 1/97
- HEARINGS REQUIRED TO RESOLVE ALL OTHER LOCAL COMPETITION ISSUES BY 1/97
- MAKE SOME RULE MODIFICATIONS FOR ENTRY AND INTERCONNECTION AND TO PROTECT CONSUMERS

WHAT PRICING FLEXIBILITY SHOULD BE ADOPTED?

- SYMMETRICAL RULES REGARDING PACKAGING OF LOCAL SERVICES
- WHEREVER WE FACE COMPETITION, LOCAL EXCHANGE SERVICE AUTOMATICALLY CATEGORY II

INITIATE INTERIM LOCAL COMPETITION, BUT:

- COORDINATE RELATED PROCEEDINGS
- ADHERE TO INFRASTRUCTURE REPORT DATE OF 1/97 FOR ALL MARKETS

SHOULD THERE BE INTERIM UNBUNDLING OR RESALE? - NO

SHOULD THERE BE INTERIM UNIVERSAL SERVICE FUNDING?

NO, AS LONG AS FACILITY BASED COMPETITION ADOPTED WITH NO RESALE AND NO UNBUNDLING

WHAT DOES FACILITY BASED COMPETITION LOOK LIKE?

FOR FACILITIES BASED LOCAL COMPETITION, C-LECS WILL NEED AN EFFICIENT AND REASONABLE MECHANISM TO PERFORM THE FOLLOWING FUNCTIONS:

- **COMPLETE LOCAL CALLS**
- **COMPLETE INTRALATA TOLL CALLS**
- **ACCESS TO INTEREXCHANGE CARRIERS**
- **ACCESS TO OTHER C-LECS**
- **COMPLETE E-9-1-1 CALLS**
- **DIRECTORY ASSISTANCE ACCESS/LISTING FEEDS**
- **ACCESS TO OPERATOR EMERGENCY VERIFY AND INTERRUPT**
- **INTERIM NUMBER PORTABILITY**
- **ACCESS TO NUMBERING RESOURCES**

WE WILL BE ABLE TO OFFER THE ABOVE FUNCTIONS BY JANUARY 1, 1996

COMPENSATION SHOULD BE RECIPROCAL

INTERCONNECTION SHOULD BE AT MEET POINTS THAT EACH PARTY SELECTS FOR TERMINATION OF TRAFFIC ON THE OTHER'S NETWORK.

Decision **PROPOSED DECISION OF ALJ PULSIFER** (Mailed 11/3/2000)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's
Own Motion into Reciprocal Compensation for
Telephone Traffic Transmitted to Internet Services
Providers Modems.

Rulemaking 00-02-005
(Filed February 3, 2000)

(See Appendix A for List of Appearances.)

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O P I N I O N

I. Introduction

By this decision, we address the question as to whether "reciprocal compensation" should be paid for telephone calls terminated to Internet Service Providers (ISPs). "Reciprocal compensation" as defined by the Telecommunications Act of 1996 (Act) provides recovery of the costs incurred by carriers to terminate local telephone calls.¹ In opening this rulemaking, we stated we would examine, among other things:

1. the nature of ISP traffic,
2. the basis and justification for reciprocal compensation and consideration of revenues competitive local exchange carriers generate in providing access service to ISPs,
3. the impact of the Federal Communications Commission's (FCC) February 25, 1999 Declaratory Ruling on Decision (D.) 98-10-057, as modified by D.99-07-047,
4. alternative compensation arrangements, and
5. if warranted and proper, the level and make up of a proper reciprocal compensation rate(s) for ISP-bound traffic.

Based on the record before us, we conclude that ISP calls meet the criteria for treatment as local calls subject to reciprocal compensation. We therefore adopt as a preferred outcome in interconnection agreements that carriers treat locally rated calls to ISPs in the same manner as other local traffic. Where parties agree to reciprocal compensation for other local traffic, our preferred outcome is

¹ For purposes of reciprocal compensation, "termination" means switching and delivering local telephone traffic to the called party's premises. See C.F.R. § 51.701(d).

that ISP-bound calls likewise be subject to reciprocal compensation on the same basis.

II. Background

The issues we address in this rulemaking continue our program to promote a competitive telecommunications market within California. In this endeavor, we are guided by both federal and state rules. Relevant federal rules are prescribed by the Act as well as by various orders that have been issued by the FCC. We are also guided by applicable federal court cases. At the state level, we are guided by the Commission's rules that have been adopted in various dockets, including the Local Competition proceeding (R. 95-04-043/I.95-04-044) and the Open Access and Network Architecture Development (OANAD) proceeding (R.93-04-003/I.93-04-002).

The question at issue in this OIR is whether the reciprocal compensation provisions of the Act should continue to apply to calls using the public switched telephone network (PSTN) to access the Internet through an ISP. An ISP provides access to information and services on the Internet over local phone lines leased by the ISP from a local exchange carrier (LEC) connecting their modems with the LEC's switching facility. The ISP enables users to connect to its modem and access the Internet by simply dialing a local phone number with no toll charges.

As a context for resolving the issues presented in this OIR, we review the events that have led to the present dispute. Beginning in the mid-1990s, the local exchange market was opened to competition pursuant to both state and federal law. Under the previous monopoly era, the incumbent local exchange carrier (ILEC) typically handled both call origination and termination functions within a local area since both the calling and called parties were ILEC customers. With the opening of the local market to competition, however, an originating caller may be

served by one LEC while the called party may be served by a competing LEC (CLEC). Consequently, CLECs must interconnect their networks, and negotiate interconnection agreements as to how to compensate each other in the mutual delivery of calls.

The 1996 Act sets forth the federal framework for local competition generally, and particularly for LECs' obligations to compensate each other for the delivery of local calls. Section 252 of the Act imposes upon state commissions the statutory duty to approve voluntarily negotiated interconnection agreements and to arbitrate interconnection disputes in accordance with the provisions of the Act.

Under the Act, different means of intercarrier compensation are authorized depending on whether calls are classified as "local" or interexchange. Section 251(b)(5) of the Act requires LECs "to establish reciprocal compensation arrangements for the transport and termination of telecommunications."

(47 U.S.C. § 251(b)(5).) Although § 251(b)(5) purports to extend reciprocal compensation to all telecommunications, the FCC has construed the reciprocal compensation requirement as limited to local traffic. (47 CFR § 51.701(a).) Under standard reciprocal compensation provisions of interconnection contracts, the cost of terminating a local call that originates from LEC's network and terminates on another LEC's network is attributed to the LEC from which the call originated. (47 CFR Sec. 51.701(e), 51.703).

Long distance calls continue to be compensated with "access charges," as they were before the 1996 Act. Access charges are not paid by the originating LEC. Instead, the long-distance carrier pays both the LEC that originates the call and links the caller to the long distance network, and the LEC that terminates the call. (See *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 16013 (p. 1034) (1996)

("Local Competition Order").) Thus, payment of reciprocal compensation for terminating calls is mandatory under the Act for all "local" calls.

Under the 1996 Act, state regulatory commissions have the responsibility to determine: (1) which calls will be defined as or treated as "local" calls for purposes of making reciprocal compensation applicable to such calls when handled by more than one carrier, and (2) the rate levels and rate structure of reciprocal compensation in that state. The FCC has the jurisdictional authority to establish parameters within which state commissions carry out these responsibilities.

In the initial round of interconnection agreements negotiated between ILECs and competitive local exchange carriers (CLECs), no particular controversy was evident concerning whether calls to ISPs were properly included as local calls subject to reciprocal compensation. CLECs included ISP calls in its local traffic for which reciprocal compensation payments were billed. Initially, the ILECs did not express disagreement with this treatment, but paid reciprocal compensation to CLECs for such ISP calls. Beginning in about 1998, however, the ILECs began to take the position that ISP-bound calls did not constitute local calls as defined by the Act, and discontinued payment of reciprocal compensation to CLECs for terminating such calls.

III. Procedural History and Scope of this Proceeding

The carriers dispute over the treatment of ISP calls was first formally brought before this Commission in the Local Competition proceeding (R.95-04-043/ I.95-04-044). A group of parties identified as the California Telecommunications Coalition (Coalition) filed a motion in that proceeding for a Commission order that the reciprocal compensation provisions under the Act apply to ISP-bound traffic. In D.98-10-057, we granted the motion, concluding that such ISP calls are local and are subject to the reciprocal compensation provisions of applicable interconnection agreements.

On February 25, 1999, the FCC adopted federal rules relating to the question of whether ISP-bound calls constitute local traffic.² In the Declaratory Ruling, the FCC stated that for jurisdictional purposes, ISP-bound traffic should be analyzed on an end-to-end basis, rather than by breaking the traffic into component parts. The FCC stated that the communications at issue do not terminate at the ISP's local server, but continue on to the ultimate destination or destinations at an Internet web site that is often located in another state. (Declaratory Ruling ¶ 12.) The FCC noted that it had previously distinguished between the "telecommunications component" and the "information services component" of end-to-end Internet access for purposes of determining which entities are required to contribute to universal service. The FCC had also previously concluded that ISPs do not appear to offer "telecommunications service" and thus are not "telecommunications carriers." Nonetheless, the FCC stated it had never found that "telecommunications" end where "enhanced" service begins. (*Id.*, ¶ 13.) The FCC's Order thus found that while ISP-bound traffic is "jurisdictionally mixed," it appeared to be "largely interstate." The FCC rejected the two-component theory for calls to ISPs, applied a one-communication theory, and found that the reciprocal compensation requirement of Section 251(b)(5) of the Act did not govern inter-carrier compensation for ISP-bound traffic.³

The FCC, however, did not decide whether reciprocal compensation would be due in any particular circumstance. Parties could voluntarily agree to reciprocal

² FCC Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, adopted February 25, 1999

³ *Id.*

compensation, or a state regulatory body could impose such payment obligations on carriers in arbitrating interconnection agreement disputes under Section 252 of the Act.

Both GTE California, Incorporated, now known as Verizon California Inc. (Verizon), and Pacific Bell (Pacific) applied for rehearing of D.98-10-057, arguing that because the FCC had determined that calls to ISPs are jurisdictionally interstate, this Commission could not require that those calls be subject to reciprocal compensation. We denied rehearing. In D.99-07-047, we explained that the FCC's Declaratory Ruling did not negate our prerogative to treat ISP-bound calls as local for purposes of reciprocal compensation. Notwithstanding the FCC's designation of ISP-bound traffic as "largely interstate" for jurisdictional purposes, our authority over interconnection agreements pursuant to Section 252 extends to both interstate as well as intrastate matters. Irrespective of how ISP traffic is categorized for jurisdictional purposes, the FCC did not intend to preempt or interfere with state commission decisions regarding compensation for ISP-bound traffic. The FCC declared that: "Until adoption of a final rule, state commissions will continue to determine whether reciprocal compensation is due for this traffic."

Although in D.99-07-047, we upheld our previous decision authorizing the payment of reciprocal compensation for ISP-bound calls under then-existing interconnection agreements, we determined that a more in-depth and comprehensive inquiry into the whole question of ISP reciprocal compensation was warranted for purposes of prospective policy making. Accordingly, this OIR was opened on February 15, 2000, to revisit the reciprocal compensation policies relating to ISP-bound traffic previously addressed in the Local Competition proceeding. In particular, we sought to reexamine the question of whether reciprocal compensation should be required for the delivery of ISP-bound traffic in

view of the FCC Declaratory Ruling finding ISP calls to be largely interstate in nature.⁴

A scoping memo was issued on May 2, 2000, (Scoping Memo) categorizing this proceeding as ratesetting, and bifurcating the proceeding into two phases. Phase 1 of the proceeding was designated to reexamine the question of whether Commission-mandated payment of reciprocal compensation for ISP-bound traffic is appropriate. Depending on the outcome of Phase 1, the need for further proceedings would be determined if specific rates for transport and delivery of ISP-bound traffic needed to be adjudicated. Phase 1 also deferred considerations of issues relating to the use of disparate rating and routing points and related intercarrier compensation issues that were the subject of D.99-09-029. These issues were identified for further consideration in the OIR issued on February 15, 2000, but will be considered in a subsequent phase of the proceeding.

In the Scoping Memo, certain policy issues were designated to be addressed through written comments, and certain factual issues to be addressed through

⁴ On March 24, 2000, the District of Columbia (D.C.) Circuit Court vacated the FCC's declaratory ruling, and remanded the matter. See Bell Atlantic Telephone Companies v. Federal communications Commission, 206 F.3d 1, 5-6 (D.C. Circuit Mar. 24, 2000). The D.C. Circuit found that the FCC had failed to explain adequately why its end-to-end analysis, which had been previously used solely in jurisdictional determinations, was also applicable in determining whether reciprocal compensation was due for termination of ISP calls. In finding that the FCC had not supplied a "real explanation" for its decision to treat end-to-end analysis as controlling, the D.C. Court vacated the ruling and remanded the case. As of this date, a further ruling from the FCC remains pending. Resolution of the remanded issues involved in the declaratory ruling remains a precondition for the FCC's release of its rules concerning intercarrier compensation for ISP-bound traffic and the scope of state PUC authority with respect thereto. Once the issues which are the subject of the FCC's vacated declaratory ruling are resolved, the FCC will presumably issue its rules applicable to intercarrier compensation for ISP-bound traffic.

prepared testimony. Opening and reply comments on the policy issues were filed on July 14 and August 4, 2000, respectively. Evidentiary hearings on the factual issues were conducted from August 14 through 29, 2000. Testimony representing the views of the ILECs was offered by Pacific, Verizon, and Roseville Telephone Company (Roseville). Testimony representing the views of CLECs was presented by Pac-West Telecom, Inc. (Pac-West), ICG Telecom Group, Inc. (ICG), Focal Communications Corporation (Focal), and RCN Telecom Services of California (RCN). Other CLECs joined in filing written comments, but did not serve testimony.⁵ The California Internet Service Providers Association (CISPA) also offered testimony representing the views of its member ISPs. Ratepayer interests were represented by the Commission's Office of Ratepayer Advocates (ORA) and The Utility Reform Network (TURN). Opening and reply briefs were filed on September 18 and October 2, 2000, respectively. Oral arguments were held before the Commission on November 7, 2000. Over 170 exhibits were admitted into the record, with 1898 pages of hearing transcript.

IV. Overview of the Proceeding

A. Parties' Proposals

The active parties in this proceeding form into two opposing groups. Those parties representing ILECs all seek an immediate end to the existing Commission policy calling for the payment of reciprocal compensation for ISP traffic. The ILECs support an alternative approach characterized as "bill-and-keep," whereby no LEC would compensate any other LEC for delivery of ISP traffic. Instead, each

⁵ Other CLECs filing comments included AT&T Communications of California, Level 3 Communications, Time Warner Telecom of California, and Western Telephone Integrated Services.

LEC would recover any necessary costs from their own customers for delivery of ISP traffic.

The parties representing CLECs and CISPAs oppose the "bill-and-keep" proposal, and advocate instead continuation of the Commission's existing policy regarding the payment of reciprocal compensation for the delivery of dial-up ISP traffic. ORA supports the CLECs' and CISPAs' position. TURN expressed neutrality on the issue of intercarrier compensation, but opposed the ILECs in claiming that they suffered financial losses from ISP reciprocal compensation warranting any form of retail ratepayer relief.

B. Summary Conclusions and Framework for Approaching the Issues

As a basis for approaching the issue of reciprocal compensation, we first consider the legal requirements of the Act, and whether, as a matter of law, the provisions of the Act prescribing the payment of reciprocal compensation apply to ISP-bound calls. If a call is found to be local as defined under the Act, and the incoming and outgoing flow of traffic is out of balance, then reciprocal compensation must be paid by law. No further inquiry would be necessary as a basis to require such payment.

If, on the other hand, ISP-bound calls are found not to be local, as defined by the Act, then reciprocal compensation is not required by federal law. Nonetheless, the FCC has given this Commission latitude either to impose reciprocal compensation requirements on ISP-bound traffic, or to refrain from doing so, as deemed appropriate based on other relevant factual considerations.⁶

⁶ Id. ¶ 28.